CHAPTER VI

PUBLIC REVENUE - DIRECT AND INDIRECT TAXES

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CHAPTER VI

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I. Definitions:-

Direct taxes are taxes imposed by the state upon persons who are expected to bear the burden of these taxes and who are not expected to be able to shift the tax burdens to other persons. In other words in the case of a direct tax, the tax-payer is also the tax-bearer at least in the expectation of the lawgiver. If the Government levies a tax upon the incomes of its servants and collects the tax by deducting it from salaries then the tax levied upon the Government officials is also ultimately paid by them. This tax upon the incomes of these officials cannot be shifted by them to other persons and so it is a direct tax.

Indirect taxes are taxes which are imposed upon persons who are expected to shift the burden of the tax to other persons.

Suppose the Government imposes a tax upon books imported from abroad, and the book-sellers realise the tax which they pay to the Government by selling the books at higher prices to purchasers; then the tax on books is an indirect tax. The tax is first imposed upon the book-sellers but it is ultimately shifted by them to the book-buyers.

The principal direct taxes are the land taxes, property taxes, poll taxes and income taxes; the indirect taxes are the custom duties, excise taxes, most fees and licenses.

Many writers doubt whether after all, the distinction between direct and indirect taxes is a real one, since many taxes which seem to be direct, at first sight, are regularly shifted to others.

II. Advantages and Disadvantages of Direct Taxes:-

(A) Advantages:-

1) Direct taxes are proportionate to income or property and in this way they are more equitable (just) than indirect taxes. Also in the case of direct taxes alone, the important principle of graduation (progression) can be applied to income or property according to amount and source etc.

2) In rich and progressive modern states like Britain, direct taxes like the Income Tax (and the super-tax) and ~~Death~~ Duties (Inheritance Taxes) etc., are also very productive, and contribute the greater part of the total revenue of the nation. Also the Income Tax introduces a very valuable and much-needed element of elasticity into the tax-system of the country.

3) Another advantage attaching to direct taxation is that it is collected at the source and so there is less chance of evasion.

4) The tax-payer also knows definitely what he has to pay and when and why. So governments are compelled to be economical and careful. "If you had only direct taxes, you would have economical government" said Gladstone.

(B) Disadvantages:-

1) Direct taxes being directly paid by the tax-payers are more felt and so are more unpopular than indirect taxes.

2) Another difficulty is the necessity of assessment in all direct taxes. There must be a valuation of the object upon which it is charged and this affords opportunity for evasion on the part of the tax-payer and for arbitrary official action.

III. Advantages and Disadvantages of Indirect Taxes:-

(A) Advantages:-

Indirect taxes are strong exactly in those points in which the direct taxes are weak.

1) Indirect taxes being paid indirectly by the tax-payers are not so much felt and therefore are more popular than direct taxes.

2) One advantage is that indirect taxes on commodities, etc., are paid by men when they spend, (not when they earn or save). So accumulation of capital is not discouraged.

3) Again indirect taxes on commodities are collected at a convenient time, since the tax-payer pays the tax when he buys the commodity: and he is at liberty to escape the tax by not buying the commodity.

4) It is also said that in a democratic country all classes should contribute to taxation; and as it is not easy to levy direct taxes upon the poor, the poor should be made to pay something by means of indirect taxes.

(B) Defects of Indirect Taxes:-

1) The greatest defect is that indirect taxes on articles of general consumption press more heavily upon the working classes than on the richer classes, this is not equitable. The labourer has to spend a greater portion of his income on necessaries than the rich man.

Indirect taxes on commodities (specially on necessaries like food, drink, clothing, etc.) fall more heavily on the poor than on the rich partly because the poor man with his much smaller income has often to pay the same rate of tax as the rich man with his much larger income.

This evil can however be diminished to some extent by taxing articles of general consumption and by levying higher duties upon superior qualities of the articles taxed.

2) At times of depression the revenue from indirect taxes often shrinks.

3) Increased rates sometimes produce stationary or even diminished receipts.

4) Expenses of collection are sometimes larger in the case of indirect taxes than in the case of direct taxes.

An examination of the merits and defects of direct and indirect taxes shows that in future direct taxes should form, a predominant part of every well-organized tax system - direct taxes consisting of the income-tax in its various forms, death duties, legacy duties, etc. Indirect taxes also have to be included in every tax-system along with direct taxes. But reliance on indirect taxation to a great extent will be unjust to the poorer classes and at times of depression will cause serious financial difficulties.

As a matter of fact, in rich and progressive countries like England, indirect taxes on account of their heavy burden on the poorer classes and other defects are being replaced more and more by direct taxes.

IV. Some Indirect and Direct Taxes Considered:-

I) Custom Taxes:-

Customs duties are taxes imposed upon commodities when they cross the boundaries of a state or of a customs

Some Indirect & Direct taxes

(1) Customs duties :- When frontier of country crossed

Opposition between two
(a) Protective – shutting out foreign imports – home industry
(b) Revenue – ~~Pri~~ C. D. imposed primarily for revenue.

(2). Internal Revenue duties or Excises.

Defects
(a). On consumers goods – Shifted largely to consumers
(b). detailed supervision in taxed industry
(c). Excess taxes – harmful to consumers

Merits – duties if properly selected
(a) Highly productive
(b) Expense of collection small
(c). Considerable amount of elasticity in such taxes

In levying these duties general principles certain to be borne in mind.

1) Taxation of necessaries should be avoided as far as possible because it weights unjustly & heavily on the poor classes

2). ~~A~~ Taxation on luxuries like taxes on – dangerous to go very (Opium & alcohol)

3). Taxation on articles whose demand is elastic should be avoided. Brings about large contraction of demand.

4). Import duties best imposed on those commodities over which the commodity has a monopoly of demand

5). Export duties best levied on commodities which exporting country has a monopoly of supply or Indian Jute in comparison for foreign countries.

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union (composed of two or more states).

Customs taxes are of two kinds: (i) Protective customs duties and (ii) Revenue duties.

Protective customs duties are taxes levied upon imported foreign goods primarily with the object of diminishing foreign competition with a corresponding domestic industry. A country imposing protective customs duties is said to have a protective tariff. Revenue duties are customs duties which are imposed primarily for securing a revenue for the Government and not for protecting domestic industry. A country imposing only revenue duties is said to have a revenue tariff. All large and powerful modern countries Britain with British India and British colonies, France, Germany, Russia and the United States, etc., have got protective tariffs.

There is a fundamental opposition between revenue and protective principles. For a duty to be adequately protective must largely shut out foreign imports and then very little revenue will be raised by such a duty. The tariff of a country does often contain some protective duties and some duties which are mainly for revenue.

Some of the most useful qualities in custom duties are:

i) high productivity

3). Income tax :- A great method of taxation in modern times

Ideal income tax

(a) Should exempt all savings from taxation → source of future capital

(b). Should be properly graduated according to faculty — small incomes exempted — moderate moderately — big ones heavily.

4). Inheritance Taxes + Death Duties :- Second great method of direct taxation in modern times is taxation of property passing at death :

Taxation of Inheritances

(a) To tax bequests to distant relatives at higher rate

(b). To make rate high for large + small for small inheritances.

Merits

(a) In conformity with Faculty theory — Ability increases as inheritance increases

(b) Easy collect + little expenditure.

Examples of taxation of property at death are found in Death Duties in Britain + Inheritance taxes in U.S.A.

ii) cheapness of collection

iii) stability and ~~responsiveness~~ to the control of the treasury.

These virtues are to be found in a larger measure in revenue duties properly selected than in a comprehensive and complicated system of protectionist duties.

Duties levied upon the value of the imported commodities are known as ad valorem; duties levied according to weight, bulk or other units of measurement (and not according to value) are known as specific duties. Obviously specific duties fall most heavily upon the coarser or cheaper grades of commodities. Ad valorem duties are however open to the objection that they offer a greater temptation to business men to make fraudulent valuation and thus to evade a part of the taxation.

2) Internal Revenue Duties or Excises:-

Internal revenue duties largely consist of excises. Excises may be defined as taxes levied on commodities produced within the country and destined for home consumption.

(a) Defects:-

Excise taxes suffer from the following defects:-

i) As these taxes are levied generally on articles of general consumption consumed even by the masses of the people, and as they are shifted in a large degree to the consumers, these taxes frequently weigh more heavily upon the poor than upon the rich.

ii) Another defect of these duties is, that in some cases they involve detailed supervision and interference with the taxed industry and this is unpopular.

iii) Excise taxes often exercise little beneficial influence upon the consumption of articles, the use of which is believed to be harmful to the consumer. This is because a high excise tax upon such commodities will often lead to adulteration instead of high price and diminished consumption.

(b) Merits:-

Internal revenue duties if properly selected have the following advantages:

i) They are highly productive
ii) and they have a considerable amount of elasticity in rich and progressive countries.
iii) The expense of collection is small.
iv) The burden of internal revenue duties is generally shared between the producer and the consumer.

It must be remarked here that these duties are productive and elastic only in rich and progressive countries. In a poor country and during a time of depression, these duties will neither be highly elastic nor highly productive.

In levying custom or excise or other taxes on commodities, the general principles to be borne in mind are:

(1) The taxation of necessaries should be avoided as far as possible as such taxation weighs very heavily and unjustly upon the poorer classes. When the need for revenue is very great, taxation of necessaries cannot be avoided; but to secure an equitable distribution, heavy taxes on the luxuries of the rich should be imposed at the same time. A prominent example of taxation of necessaries consists in food taxes.

(2) As taxation of necessaries is to be avoided as far as possible, it is proposed to levy special taxation on the luxury commodities. Taxation of harmful luxuries and other injurious articles of consumption (e.g., alcohol, opium) is generally advocated on the ground that such taxation will check harmful consumption and will at the same time secure a revenue for the Government.

(3) As far as possible the taxation of commodities, the demand for which is elastic, should be avoided. Taxa-

Taxation of such commodities brings about a large contraction of demand and a large loss of consumer's surplus to the people.

(4) The taxation of raw materials, i.e., cotton, jute, wool, etc. is injurious because

i) by adding to the cost of the raw material it may check the development of the manufacturing industries

ii) by adding to the cost of the raw material, it increases the price of the manufactured product to the consumers.

(5) The taxation of developing industries producing commodities subject to increasing returns is undesirable (and is to be avoided as much as possible) as such taxation will make the people miss the advantages of increasing returns and will increase the prices to the consumers.

(6) Commodities the supply of which is monopolised are fit subjects for taxation because such taxation will generally fall on the profits of the monopolist. A lump sum tax on a monopoly and also a tax proportionate to the monopoly revenue are paid by the monopolist out of his own monopoly profits; and the consumers escape the tax.

(7) Import duties are most profitably imposed on commodities for which the country has a monopoly of demand or the production of which is monopolised or is subject to increasing returns in the foreign country producing the

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commodity. In these circumstances a part or the whole of such duties would be paid by the foreign country.

(8) Export duties are best levied on commodities of which the exporting country has got a monopoly of supply. A good example is jute exported from India. Export duties in such cases will be paid by the foreigners to whose countries the commodities are exported.

3) The Income Tax:-

One great method of direct taxation in modern times is the Income Tax.

The ideal income tax

(a) should exempt all savings from taxation - for savings form the source of future capital, and property is to be taxed by taxes on inheritance and in other ways, and

(b) should be properly graduated according to faculty - small incomes must be exempted, moderate incomes are to be taxed at moderate rates, and large incomes at higher rates. The tax should be graduated also according to the number of dependents upon each income.

In most countries earned incomes are charged at slightly lower rates than incomes from investment.

4) Inheritance Taxes and Death Duties:-

The second great method of direct taxation in modern times is the taxation of property passing at death.

A favourite and very productive form of taxation in recent years is the taxation of inheritances, collateral or direct. The usual practice is

(a) to tax bequests to the distant relations at higher rates, and also

(b) to make the rate high for large and small for small inheritances.

The inheritance tax has the following merits:-

(1) It is in conformity with the ability or faculty theory. A man's ability to pay taxes is obviously increased when he inherits property; and the larger the inheritance the greater is the ability.

(2) Such a tax is easily collected, and without much expense.

(3) Income taxes as well as Inheritance taxes are both likely to come, to some extent, out of potential capital. As compared with Income tax, Inheritance tax has the advantage that it leaves a man his wealth during his life and it also allows him the prestige of leaving large sums at his

death and being a deferred tax to be paid on death is likely to be less unpopular than a high income-tax.

Examples of taxation of property at death are found in the Death Duties (including Estate, Legacy and Succession Duties) in Britain and the Inheritance Taxes in the United States of America. Taxes of this kind may vary

(i) with the size of the estate

(ii) with the degree of relationship of the heirs to the testator or

(iii) with the amount inherited by each individual heir.

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